Response of the Netherlands – European Commission consultation document on an EU framework for simple, transparent and standardised securitisation

This is a joint reaction of the Netherlands Ministry of Finance, the Netherlands Authority for the Financial Markets and the Dutch Central Bank, each institution with their own role and responsibilities. Please note that this reaction is subject to a parliamentary reserve.

Introductory comments

The Netherlands supports the Commission's initiative to develop a framework for simple, transparent and standardised ('qualifying') securitisations. Securitisations not only serve as an important funding source and investment class for banks, insurers and other financial institutions, it is also an important means to transfer risks to those parties that are willing and able to carry those risks. This can also contribute to achieving a more diversified investment portfolio from the perspective of the investor. Therefore securitisations are well suited to contribute to achieving one of the aims of the Capital Markets Union (CMU), which is to make capital markets function more effectively in connecting investors and those who need funding.

As a funding tool securitisations contribute to a diversified funding profile for financial institutions, which enhances financial stability. In the context of the CMU, however, the risk transfer potential of securitisations is especially relevant. Due to several underlying causes that are discussed in the consultation paper, the use of securitisations as both a funding tool and a risk transfer tool are currently under pressure, even though credit losses in large parts of the European securitisation markets (including the RMBS issued in the Netherlands) have been very limited over the past years. In our view urgent and clear steps are needed to not only ensure securitisations can contribute to meeting the goals of the CMU, but also to safeguard the viability of the EU securitisation market as a whole. Regulatory uncertainty and imbalances in the prudential treatment of qualifying securitisations compared to similar instruments such as covered bonds and the capital requirements for underlying assets need to be addressed on short notice.

Such steps would in any case need to include a recalibration of certain aspects of the capital requirements for banks and insurers investing in securitisations. This would also include the need to address the treatment of securitisations compared to other asset classes and the treatment of securitisations compared to the underlying assets of these securitisations ('non-neutrality'). The current prudential requirements for investments in securitisations do not seem to be in line with the requirements for investments in comparable asset classes, after correcting for differences in the underlying (credit) risk. This was also recognised by the European Banking Authority (EBA) in their consultation document[1]. The current prudential requirements therefore incentivise institutions to decrease their exposure to securitisations (see also our answers to questions 8C and 9-12).

Below you will find specific comments in response to the questions posed in the consultation paper. If necessary we would be more than willing to provide additional information and clarification, and we look forward to a Commission legislative proposal on this important topic.

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[1] EBA Discussion Paper on simple standard and transparent securitisations and their potential regulatory treatment', 14 October 2014.

Response to questions in the consultation paper

Question 1
A. Do the identification criteria need further refinements to reflect developments taking place at EU and international levels? If so, what adjustments need to be made?
B. What criteria should apply for all qualifying securitisations ('foundation criteria')?

Answer to questions 1A and 1B: In our view the criteria in the liquidity coverage ratio (LCR) and Solvency II delegated acts and the advice the EBA will provide on the required criteria (expected to be delivered this June), serve as a natural and sensible starting point for developing a EU framework for qualifying securitisations.

In addition we would like to point out two aspects. First, some of the criteria in the LCR and Solvency II delegated acts may need further clarification or refinement. This would make sure that the prudential criteria herein do not form a disproportionate obstacle in practice. An example would be article 13 2(c) of the LCR delegated act which stipulates the need to demonstrate enforceability against any third party. From a prudential perspective however it might suffice to demonstrate enforceability against the seller of the securitisation. The proposed criteria in the aforementioned EBA consultation paper also do not stipulate the need to demonstrate enforceability against *any* third party.

Second, the criteria in the LCR and Solvency II delegated acts specify that only senior tranches of securitisations qualify. In our view a framework for qualifying securitisations could also include non-senior tranches. These tranches could in practice equally comply with the qualifying criteria. Moreover, including non-senior tranches is relevant in the context of the CMU as these tranches would in practice need to deliver the transfer of credit risk. Nonetheless we would not object to adding additional (credit) risk features to the qualifying framework – as proposed in the consultation paper – to counterbalance the inclusion of non-senior tranches within the qualifying framework. Additional risk features would however need to be carefully drafted to avoid that parts of the EU securitisation market would not be able to comply with these risk features, whilst having a proven excellent credit loss track record. Grandfathering clauses for outstanding securitisations may also be necessary in these cases.

As a final point, the consultation paper provides several examples of possible foundation criteria. We support the examples presented in the paper, notably the exclusion of re-securitisations, the requirement for the underlying asset pool to be homogenous and the need for a sufficiently robust transfer of the underlying exposures to a securitisation vehicle from a legal point of view ('true sale'). These requirements would in our view need to apply to all qualifying securitisations.

Question 2
A. To what extent should criteria identifying simple, transparent, and standardized short-term securitisation instruments be developed? What criteria would be relevant?
B. Are there any additional considerations that should be taken into account for short-term securitisations?

Answer to questions 2A and 2B: When considering the potential impact of securitisation on the real economy, Asset-Backed Commercial Paper (ABCP) is a valuable tool. We agree the characteristics of short term paper like ABCP are fundamentally different from longer-term securitisations and that these differences necessitate a specific approach. However we feel we should first implement a qualifying securitisation framework

focussing on general longer-term securitisations before extending this framework to for example ABCP (please also see the answers to questions 9 to 12). Any possible future criteria related to 'qualifying' ABCP would in any case need to take into account the heterogeneous nature of the underlying assets, the greater need for liquidity support and the role of the sponsor.

Question 3
A. Are there elements of the current rules on risk retention that should be adjusted for qualifying instruments?
B. For qualifying securitisation instruments, should responsibility for verifying risk retention requirements remain with investors (i.e. taking an "indirect approach")? Should the onus only be on originators? If so, how can it be ensured that investors continue to exercise proper due diligence?

Answer to questions 3A and 3B: The risk retention rules are one of the most important regulatory reforms related to securitisations after the financial crisis, significantly improving the alignment of interest of originators and investors. We do not see elements in the current rules that need to be adjusted for qualifying securitisations. The indirect approach would also need to be applied to qualifying securitisations, even though it might not always be straightforward for investors to verify whether originators comply with the risk retention requirements.

Question 4
A. How can proper implementation and enforcement of EU criteria for qualifying instruments be ensured?
A number of aspects need to be considered when deciding on the implementation and enforcement of qualifying securitisations. These aspects encompass the trustworthiness and reliability of the qualifying label, the ease and timeliness of the certification process, both *ex ante* and *ex post*, and the manner in which the implementation and enforcement of the criteria affect moral hazard and due diligence. We see two possible avenues for the implementation and enforcement of the qualifying framework:

1) self-attestation by issuers;
2) certification by an independent non-profit party, not being a supervisory authority.

Having the originator check whether the securitisation complies with the qualifying criteria provides timely certification. Also it may not weaken the incentives for thorough due diligence by investors. In addition the administrative burden may be lower due to the fact that in-depth knowledge of the securitisation is already available at the originating party. In this scenario, prudential supervisors could however still be responsible for verifying whether issuers have adequate internal processes and arrangements in place that would justify self-attestation, as was also suggested by the ECB and the Bank of England in their common response to this consultation.

Certification by an independent and non-profit third party could on the other hand increase market confidence in the qualifying framework. Putting the certification process in the hands of a single third party moreover prevents interpretation differences of the applicable criteria. However, supervision of this independent party is necessary to ensure correct implementation of the qualifying framework.

As both options have merits and drawbacks, we want to advocate further discussions with market parties and supervisors. In either scenario it will be important to make sure

that investors themselves retain a large responsibility for verifying compliance with retention requirements and to continue engaging in proper due diligence. This is key in order to minimise moral hazard risks.

One way to ensure on-going enforcement of the qualifying criteria is to introduce a responsibility for the originator to report any significant change to the structure of the securitisation.

B. How could the procedures be defined in terms of scope and process?
For issuers it is of key importance that the process can be undertaken in a simple, standardised and timely manner. It is important to limit as much as possible the administrative burden on issuers that want to certify a securitisation. The use of standard templates would therefore be preferred. In addition standard reporting increases the ease with which investors can check the qualifying status. The scope should always encompass the entirety of the criteria relevant to achieving qualifying status.

C. To what extent should risk features be part of this compliance monitoring?
In case risk features are included in the qualifying criteria, it would in principle be logical to include them in compliance monitoring as well, taking into account potential risks related to moral hazard as mentioned in the answer to question 4A.

Question 5
A. What impact would further standardisation in the structuring process have on the development of EU securitisation markets?
B. Would a harmonised and/or optional EU-wide initiative provide more legal clarity and comparability for investors? What would be the benefits of such an initiative for originators?
C. If pursued, what aspects should be covered by this initiative (e.g. the legal form of securitisation vehicles; the modalities to transfer assets; the rights and subordination rules for noteholders)?
D. If created, should this structure act as a necessary condition within the eligibility criteria for qualifying securitisations?

Answer to questions 5A to 5D: Criteria related to standardisation should be part of a legislative proposal for a harmonised EU framework for qualifying securitisations, and compliance with these criteria should be a necessary condition for a 'qualifying' securitisation. Care should however be taken that requirements are feasible in practice and contribute to achieving the aims of the securitisation initiative. For example, in the aforementioned consultation paper the EBA proposes that voting rights are assigned to the most senior credit tranches. However this might deter investors in non-senior tranches, which is crucial for achieving risk transfer. It is most important to ensure *ex ante* that the rights and subordination rules are clear to investors in all the different securitisation positions.

With respect to the modalities to transfer assets, we refer to our remark on true sale in the answer to question 1.

Question 6
A. For qualifying securitisations, what is the right balance between investors receiving the optimal amount and quality of information (in terms of comparability, reliability, and timeliness), and streamlining disclosure obligations for issuers/originators?
It is key that investors have sufficient information to assess underlying risks. For that to be possible loan-level data of good quantity and quality needs to be available. As an

example, from our conversations with market parties we understand the privately developed European Data Warehouse (EDW) provides a satisfactory quantity of data, but quality and completeness of the data are sometimes lacking. Moreover some investor reports do not contain enough information on prepayment information and default rates. Further harmonisation and standardisation of, for example, investor reports and disclosure obligations could improve the comparability, reliability and quality of information available to market parties. Additionally, further harmonisation and standardisation improves the ease with which investors can process information. Availability of information should always be contingent on privacy laws (please also see the answer to question 16 on SME securitisation).

B. What areas would benefit from further standardisation and transparency, and how can the existing disclosure obligations be improved?
Notwithstanding the areas mentioned in question 6A, further standardisation of definitions and performance metrics would be welcomed. A remaining issue is more standardised reporting on qualitative characteristics of the securitisation transaction, for example servicing characteristics.

In the Netherlands the Dutch Securitisation Association (DSA) for example already provides standard templates for customary securitisation proceedings. The DSA designed a standard which denotes criteria on disclosure and investor reporting. Dutch market parties indicate they acknowledge this kind of standardisation as useful.

C. To what extent should disclosure requirements be adjusted – especially for loan-level data – to reflect differences and specificities across asset classes, while still preserving adequate transparency for investors to be able to make their own credit assessments?
The current framework of asset class specific templates seems sufficient.

Question 7
A. What alternatives to credit ratings could be used, in order to mitigate the impact of the country ceilings employed in rating methodologies and to allow investors to make their own assessments of creditworthiness?
B. Would the publication by credit rating agencies of uncapped ratings (for securitisation instruments subject to sovereign ceilings) improve clarity for investors?

Answer to questions 7A and 7B: We are of the opinion that an EU framework for qualifying securitisation is not the appropriate venue to address the issue of sovereign ceilings. Sovereign ceilings are not only relevant in the context of securitisations, but also exist in other asset classes - such as covered bonds - that are not part of this initiative. Sovereign ceilings are applied by rating agencies to include estimates of country/sovereign risk that might not be captured in their basic structured finance methodologies, as discussed by the EBA in their aforementioned consultation paper. It is clear that these caps will subsequently lead to lower ratings for securitisation tranches issued in those jurisdictions, thereby leading to higher capital requirements for investing in these positions. Sovereign ceilings can in theory be removed, however the perceived underlying country risk will not disappear. Removing ceilings would therefore risk underestimating the (total) credit risk of a securitisation, which is not to be welcomed, especially not in the context of a ‘qualifying’ securitisation. Therefore it would be preferable if – as suggested in question 7B – that rating agencies publish both capped and uncapped ratings. This enables investors to gauge the impact of country ceilings, subsequently deciding for themselves whether they are of the opinion that rating agencies accurately estimate sovereign risks. Given that rating agencies seem to

increasingly provide more information on capped ratings, further regulatory measures might not be necessary to achieve this aim.

Question 8
A. For qualifying securitisations, is there a need to further develop market infrastructure?
Keeping information accessible is of great importance to the well-functioning of the securitisation market. The EDW is proving very useful and access to a central information repository should be kept. As mentioned in the answer to question 6A quality and completeness of the information available to market parties could however be further improved.

B. What should be done to support ancillary services? Should the swaps collateralisation requirements be adjusted for securitisation vehicles issuing qualifying securitisation instruments?
SPV's which qualify under EMIR as (non-)financial counterparties above the clearing threshold, need to provide collateral for derivative transactions. Considering covered bond issuing entities are exempt from providing collateral, we feel securitisation SPV's should be treated in the same way as they share many characteristics. We support the remarks made by the ECB and Bank of England on this issue in their common response to this consultation.

As was also signalled by the Bank of England and the ECB in their paper dated 29 May 2014, another potential concern relates to minimal rating requirements for swap providers that are necessary for a securitisation to obtain a given rating. Downgrades of swap providers lead to the need to provide additional collateral, and could eventually require replacing the swap provider. However other external swap providers might not be readily available in a stressed environment, or only at significant costs, taking into account that the number of highly rated swap providers has decreased over the past years. This would be a concern in situations where one external swap provider would need to be replaced by another external provider. Often the originator of the securitisation acts as the swap provider ('internal' swap provider). Also in these cases a situation of financial stress might lead to the need to find an external swap provider if the originator is faced with rating downgrades. There is no easy solution to this matter. At a minimum, investors need to be able to factor in the risk of a rating downgrade of swap providers in their decision making.

In any case this is not to say that swaps would need to be excluded from a qualifying securitisation framework. Swaps that are for example used to hedge interest rate and currency risks need not be complex, may reduce risk for investors and provide more simplicity for investors as these (non-credit) risks would not need to be estimated by investors any more.

C. What else could be done to support the functioning of the secondary market?
As issuance has decreased markedly since the financial crisis, large investors such as institutional investors find it difficult to refinance large securitisation portfolio's. As liquidity diminishes they shift to other asset classes. Making sure the capital and liquidity treatment of securitisations is more in line with the underlying risks and more in line with comparable asset classes such as covered bonds, will in our view also contribute to improving the market liquidity of securitisations and the functioning of secondary markets (please also see the answers to questions 9 to 12 below).

Question 9
With regard to the capital requirements for banks and investment firms, do you think that the existing provisions in the Capital Requirements Regulation adequately reflect the risks attached to securitised instruments?

Question 10
If changes to EU bank capital requirements were made, do you think that the recent BCBS recommendations on the review of the securitisation framework constitute a good baseline? What would be the potential impacts on EU securitisation markets?

Question 11
How should rules on capital requirements for securitisation exposures differentiate between qualifying securitisations and other securitisation instruments?

Question 12
Given the particular circumstances of the EU markets, could there be merit in advancing work at the EU level alongside international work?

Answer to questions 9 to 12: In our view concrete steps are needed in the short to medium term to complement a framework for qualifying securitisations with a recalibration of capital and liquidity requirements for banks and capital requirements for insurers investing in securitisation positions. This adjustment in the capital treatment can be justified on the basis that qualified securitisations would need to comply with multiple criteria related to simplicity, transparency and standardisation. We propose the following <u>two-step approach</u>:

<u>Step 1</u>: a Commission legislative proposal containing an EU framework for qualifying securitisations that contains criteria for qualifying securitisations and can be applied across all sectors. As such, the legislative proposal should be overarching and specific regulatory frameworks such as CRR and Solvency II should be able to refer to the criteria in the overlaying legislative proposal. Part of step 1 should also be a roadmap that contains sector-specific (legislative) actions for the short to medium term. This would help to find a balance between on the one hand recognising that not all sector-specific modifications can be made at short notice, and on the other hand provide as much clarity as possible to market participants on the anticipated future changes to the EU securitisation framework. This would help reduce regulatory uncertainty.

<u>Step 2</u>: As a second step – and complementing the overarching legislative proposal in step 1 - sector-specific action is needed in the short to medium term including further legislative proposals where necessary (although these proposals would not necessary all have to be tabled simultaneously). This could contain at least the following:

a) the EBA is currently engaged in further in-depth analysis on the calibration of bank capital requirements in relation to the introduction of qualifying securitisations, and is expected to deliver concrete results around June 2015. In case the EBA proposes concrete recommendations related to the capital treatment of qualifying securitisations, the Commission should come up with a legislative proposal to amend the CRR to take this on board. This would need to include any possible recommendations by the EBA related to (non-)senior tranches and the issue of non-neutrality. A qualifying securitisation framework should aim at more appropriate levels of non-neutrality of capital charges for banks investing in qualifying securitisations. Currently, capital requirements for securitisation positions can be several multiples of the requirements that are applicable to the underlying assets. This does not seem justified for qualifying securitisations as the criteria mitigate uncertainty related to the securitisation structure;

b) integrating the new Basel securitisation framework in EU legislation. Alignment with this new Basel framework should be aimed at. This would nevertheless need to take into account EU specificities were justified. The EBA would be well equipped to advise on the aspects of the new Basel framework that might need modification in the context of the EU;

c) the Basel Committee is currently also investigating the need to come up with a framework for 'simple, transparent and comparable' securitisations. This includes an investigation whether the new Basel securitisation framework would need to be amended accordingly. Alignment with Basel criteria on 'simple, transparent and comparable' securitisations should be aimed at as well, again taking into account possible EU specificities that the EBA might put forward;

d) investigating whether the EU framework for qualifying securitisations in step 1 could be expanded. This could include looking into the merits and drawbacks of allowing certain synthetic securitisations to be included in the qualifying framework, as these type of securitisations need not be complex in all cases and could be especially relevant in the context of SME securitisations. The possible inclusion of short term securitisations into the qualifying framework could also be investigated. In any case, short term and synthetic securitisations could be considered 'out of scope' until further notice. This implies that these type of securitisations will initially – at least in step 1 - not be considered either qualifying or non-qualifying, thereby retaining the current prudential requirements for these instruments for the time being;

e) address important remaining and broader issues related to 1) capital requirements for insurers investing in securitisations and 2) the relative treatment of investments by banks in securitisations compared to similar asset classes from the perspective of liquidity requirements:

    1. the Commission could issue a call for advice for EIOPA specifically on the capital requirements for insurers investing in qualifying securitisations. This call could encompass amongst others the treatment of securitisations compared other asset classes and possibilities for improving risk sensitivity (please also see our answer to question 14A);
    2. the relative treatment of securitisations compared to other asset classes is a very important consideration for banks whether or not to invest in securitisation positions. To this end, the Commission could issue a call for advice for EBA on the liquidity treatment of qualifying securitisations. In our view the calibration of securitisations and covered bonds in the LCR delegated act creates disproportionate incentives to invest in covered bonds compared to securitisations. This can be adjusted by for example moving ECAI 2 covered bonds from level 2A to level 2B in the liquidity buffer. This would *ceteris paribus* enhance incentives to invest in securitisations, without decreasing the level of prudence of the LCR-standard as a whole. The Commission could propose these type of adjustments by making use of their mandate to review the LCR delegated act at any time in accordance with CRR article 462.

Question 13

Are there wider structural barriers preventing long-term institutional investors from participating in this market? If so, how should these be tackled?

A lack of access to easily comparable information and inappropriate capital treatment relative to comparable asset classes may present barriers to participation by institutional investors. See also our answers to questions 6 and 8.

Question 14

A. For insurers investing in qualifying securitised products, how could the regulatory treatment of securitisation be refined to improve risk sensitivity? For example, should capital requirements increase less sharply with duration?
Solvency II introduced a differentiated treatment for Type 1 securitisation. In our view, this is an important step in moving towards a qualifying framework. Risk sensitivity could be improved by ensuring that capital requirements increase less sharply with duration, by differentiating capital treatment between credit quality steps and by more suitably differentiating between the capital treatment of whole loans and the securitisation of these loans (non-neutrality).

B. Should there be specific treatment for investments in non-senior tranches of qualifying securitisation transactions versus non-qualifying transactions?
As stated in the answer to question 1, non-senior tranches should in our view not be excluded from the qualifying framework. Non-senior tranches could still adhere to the simplicity, transparency and standardisation criteria. The capital treatment of a securitisation should subsequently make a distinction between senior and non-senior tranches.

Question 15

A. How could the institutional investor base for EU securitisation be expanded?
We feel the qualifying framework will contribute to expanding the investor base for securitisations through addressing the stigma that is currently attached to securitisations, providing harmonisation and standardisation and promoting a more suitable capital treatment in relation to the underlying risks and relative to comparable asset classes.

B. To support qualifying securitisations, are adjustments needed to other EU regulatory frameworks (e.g. UCITS, AIFMD)? If yes, please specify.
Decisions on harmonisation of definitions and disclosure requirements made in the context of this qualifying framework should be implemented across the different regulatory frameworks to improve the functioning of the market and to create a level playing field for both investors in and issuers of securitisations. Please also refer to our remarks related to EMIR in the answer to question 8B.

Question 16

A. What additional steps could be taken to specifically develop SME securitisation?
Investing in SME securitisation means assessing a relatively heterogeneous portfolio of loans. The ease with which this portfolio can be assessed is therefore of great importance for the functioning of this market. The availability of standardised and comparable information, while considering privacy laws, is therefore crucial.

It is important for all tranches of a securitisation to qualify for the framework, although their capital treatment should of course reflect the differences in the underlying credit risk. As argued in the answers to questions 9 to 12, we also feel the inclusion of certain synthetic securitisations in the qualifying framework could be considered at a later stage.

B. Have there been unaddressed market failures surrounding SME securitisation, and how best could these be tackled?
Information asymmetry remains an important market failure in the SME securitisation. The steps to improve information provision mentioned in earlier questions could help alleviate these concerns.

C. How can further standardisation of underlying assets/loans and securitization structures be achieved, in order to reduce the costs of issuance and investment?
Standardisation plays an central role in the Dutch securitisation market. Using templates, issuers can quickly provide information and investors can quickly ascertain or compare specific information on underlying assets or the structure of the transaction.

D. Would more standardisation of loan level information, collection and dissemination of comparable credit information on SMEs promote further investment in these instruments?
Please see the answers to questions 16A to 16C.

Question 17
To what extent would a single EU securitisation instrument applicable to all financial sectors (insurance, asset management, banks) contribute to the development of the EU's securitisation markets? Which issues should be covered in such an instrument?
Standardisation is of great importance to develop the EU's securitisation market. Standardisation facilitates comparison and the investment decision. We therefore welcome a harmonized set of criteria for banks, insurers and other relevant actors that define solid securitisations. National legal differences however exist, which make the development of a single pan-European securitisation instrument challenging. Assets underlying securitisations may also differ between countries because of national legislation and market characteristics. Constructing a pan-European securitisation instrument will most likely also be time-consuming. The benefits of doing so might therefore not outweigh the costs.

Question 18
A. For qualifying securitisation, what else could be done to encourage the further development of sustainable EU securitisation markets?
Some market parties indicate that they would welcome a more precise definition of what constitutes a significant risk transfer. Additional guidelines on this subject would create more clarity and may encourage issuance.

In addition, one of the drawbacks of a qualifying framework could be creating cliff effects between qualifying and non-qualifying securitisations with respect to the capital requirements attached to both categories. While differentiation is appropriate, we should not negate part of a market that caters to a real investor demand. Attention should therefore be paid to a suitable capital treatment for both sets of securitisations.

B. In relation to the table in Annex 2 are there any other changes to securitization requirements across the various aspects of EU legislation that would increase their effectiveness or consistency?
Please see the answers to questions 8B and 15B.